

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-01

INR-05 NSAE-00 RSC-01 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-01

CEA-01 SAM-01 PRS-01 PA-01 USIA-06 L-02 /079 W

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FM AMEMBASSY LISBON

TO SECSTATE WASHDC 1305

INFO AMCONSUL OPORTO

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E.O. 11652: N/A

TAGS: BBSR EIND PO

SUBJ: BACKGROUND ON TORRALTA GROUP PROBLEMS

REF: (A) LISBON 5538; (B) LISBON 4604; (C) WTDR DATED NOV 12  
(LISBON 5039)

SUMMARY: THE TORRALTA GROUP OF COMPANIES IS THE LARGEST TOURISM ORGANIZATION IN PORTUGAL. DURING THE PAST TWO WEEKS THE GROUP'S TOP ADMINISTRATORS AND LARGEST SHAREHOLDERS HAVE BEEN ACCUSED OF ECONOMIC SABOTAGE AND ARRESTED (SEE REF A), ITS MANAGEMENT HAS BEEN REPLACED BY GOP ADMINISTRATORS, AND ITS ECONOMIC/ FINANCIAL STATUS IS UNDER INTENSE INVESTIGATION. THE MINISTRY OF LABOR HAD TO PAY THE SALARIES OF 2700 EMPLOYEES OF ONE OF THE GROUP'S FIRMS. THE SERIOUS PROBLEMS APPEAR TO HAVE BEEN CAUSED BY A SERIES OF COMPLEX AND YET UNCLEAR FACTORS, E.G., A DOWNTURN IN TOURISM, A LACK OF CONFIDENCE AND INVESTOR LIQUIDITY, AND POSSIBLE MISMANAGEMENT OR WORSE. THE BASIC ECONOMIC HEALTH OF TORRALTA AND THE EVENTUAL OUTCOME OF THE INVESTIGATION WILL HAVE IMPORTANT EFFECTS ON THOUSANDS OF SMALL INVESTORS, ON THE OVERALL ECONOMIC SITUATION, AND ON THE INVESTMENT IMAGE OF PORTUGAL. GOP HAS BEEN SUCCESSFUL IN KEEPING IN OPER-

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ATION THE BANK (BIP) WHICH IT TOOK OVER OCT 11, 1974 (SEE REF B),

AND IS HOPEFUL THAT IT CAN DO THE SAME WITH TORRALTA. END SUMMARY.

1. ON DECEMBER 13 THE GOP ANNOUNCED THE ARREST OF ALL FIVE OF TORRALTA'S BOARD OF DIRECTORS INCLUDING THE PRESIDENT, REAR ADMIRAL SARMENTO RODRIGUEZ. THE DETAINEES ARE ACCUSED OF THE FOLLOWING ACCORDING TO THE OFFICIAL COMMUNIQUE:

- A) INABILITY TO MEET CURRENT OBLIGATIONS SUCH AS NORMAL SALARIES, AND DEBTS TO SUPPLIERS AND CONTRACTORS;
- B) DELAY IN REIMBURSEMENT OF \$5 MILLION IN VACATION VOUCHER SHARES (SEE BELOW) AND \$4 MILLION IN DIVIDENDS TO SHAREHOLDERS;
- C) RECEIPT OF \$32 MILLION IN ADVANCE PAYMENTS FOR NEW CAPITAL WITHOUT THE AUTHORIZATION OF THE GOP;
- D) ENTRANCE INTO PORTUGAL AND TRANSMITTAL ABROAD OF FUNDS WITHOUT THE PERMISSION OF THE BANK OF PORTUGAL;
- E) IRREGULAR CORPORATE TIES BETWEEN ASSOCIATED AND OTHER COMPANIES, ESPECIALLY IN FINANCIAL AND REAL ESTATE TRANSACTIONS. ABOVE CHARGES HAVE BEEN LUMPED TOGETHER AND DESCRIBED AS "ECONOMIC SABOTAGE" BY MAJORITY OF PRESS AND POLITICAL PARTIES. SIMULTANEOUSLY WITH ARREST OF DIRECTORS GOP NAMED A SUBSTITUTE BOARD TO ADMINISTER TORRALTA AND EIGHT OF ITS ASSOCIATED FIRMS.

2. TORRALTA GROUP IS LARGEST TOURISM ORGANIZATION IN PORTUGAL. IT HAS GROWN FROM SMALL ENTERPRISE WITH ONE HOTEL IN 1965 TO A VERTICALLY INTEGRATED CONGLOMERATE WITH TOURIST FACILITIES IN ALL MAJOR TOURIST CENTERS. PARENT FIRM OWNS MAJORITY OR PART INTEREST IN AT LEAST 21 COMPANIES. THE GROUP TOGETHER OPERATES AT LEAST 12 HOTELS (WITH MORE THAN 2500 BEDS), CONDOMINIUMS, APARTMENT-HOTELS, NIGHT CLUBS, SUPERMARKETS, RESTAURANTS, THREE CASINOS, A GOLF CLUB, A CONSTRUCTION COMPANY, SKI, FISHING AND HUNTING FACILITIES, AND A FARM/RANCH TO SUPPLY FOOD TO THE EMPIRE. IT IS PRESENTLY CONSTRUCTING A 370-ACRE TOURIST/RESIDENTIAL COMPLEX AT TROIA, JUST SOUTH OF LISBON, WITH A PROJECTED CAPACITY FOR 20,000 GUESTS. GROWTH HAS BEEN PHENOMENAL; FOR INSTANCE TOTAL ACCUMULATED INVESTMENTS GREW OVER 150 PERCENT IN 1973. THE PARENT COMPANY ALONE EMPLOYS OVER 3050.

3. TOTAL ASSETS OF PARENT FIRM--TORALTA-CLUBE INTERNACIONAL DE FERIAS, SARL--AT THE END OF 1973 WERE OVER \$165 MILLION. THESE INCLUDED ROUGHLY \$65 MILLION IN LIQUID ASSETS, \$23 MILLION IN LAND, BUILDINGS, EQUIPMENT, VEHICLES, ETC., \$16 MILLION IN LIMITED OFFICIAL USE

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PARTICIPATION IN ASSOCIATED FIRMS, AND \$56 MILLION IN "INVESTMENTS IN PROCESS" (SEE COMMENT). SHORT-TERM LIABILITIES WERE LISTED AT \$18 MILLION, MEDIUM AND LONG TERM DEBT AT \$100 MILLION AND CONTINGENCY FUNDS FOR BOND PAYMENTS AT ABOUT \$33 MILLION (TOTAL LIABILITIES AT ROUGHLY \$151 MILLION). NET WORTH WAS ABOUT \$12 MILLION INCLUDING ABOUT \$9 MILLION IN PAID-IN CAPITAL AND \$1.5 MILLION IN PROFITS ACCORDING TO THE BALANCE SHEET.

4. A SIGNIFICANT AMOUNT OF TORRALTA'S CASH FLOW AND NEW CAPITALIZATION STEMMED FROM SALE OF HOLIDAY VOUCHERS (OR PRIVILEGED OWNERSHIP SHARES) WHICH ENTITLED THE BUYER TO 10 DAYS FREE STAY AT ONE OF TORRALTA'S FACILITIES IN ADDITION TO 20 PERCENT DISCOUNT ON OTHER SERVICES, OR A NET INCOME OF 10 PERCENT ANNUALLY THROUGH GUARANTEED PURCHASE OF COUPONS EACH YEAR BY TORRALTA. THESE VOUCHERS COULD BE REDEEMED WITH SIX MONTHS ADVANCE NOTICE AND BUYER WAS ALSO ELIGIBLE TO RECEIVE NORMAL COMPANY DIVIDENDS. IT IS ESTIMATED THAT AS MANY AS 20,000 SMALL INVESTORS MAY HAVE BOUGHT THESE HOLIDAY VOUCHERS. MANY OF THE INVESTORS ARE REPORTED TO BE PORTUGUESE IMMIGRANT WORKERS LIVING IN NORTHERN EUROPE. THE TOTAL OF SMALL INVESTORS IN TORRALTA MAY BE AS HIGH AS 30,000 PERSONS. (THIS SYSTEM OF CAPITALIZATION REPORTEDLY IS BASIS FOR CHARGE (C) ABOVE. IN ORDER TO RAISE LARGE AMOUNTS OF CAPITAL WITHOUT DILUTING VOTING POWER OF TORRALTA ADMINISTRATORS/OWNERS, FIRM SOLD HOLIDAY VOUCHERS IN BLOCKS OF FIVE NOMINALLY VALUED AT \$40 FOR \$320 EACH. BY NOT DENOMINATING THESE INSTRUMENTS AS NORMAL STOCK SHARES, ADMINISTRATORS RETAINED CONTROL OF FIRM. HOWEVER, GOP NEVER APPROVED THIS METHOD OF FINANCING).

5. ONE OF THE LARGEST AND MOST IMPORTANT FIRMS OF TORRALTA GROUP IS AC-TRABALHOS DE ARQUITECTURA E CONSTRUCCAO SARL (AC), A CONSTRUCTION COMPANY EMPLOYING 2700 WORKERS. AC IS 30 PERCENT-OWNED BY TORRALTA AND IS THE FIRM BUILDING THE TROIA DEVELOPMENT. THE FIRM HAS SUFFERED LABOR PROBLEMS SINCE APRIL 25, AND WAGE INCREASES, ALONG WITH REPORTED NON-PAYMENT OF DEBTS BY TORRALTA, CAUSED A SERIOUS LIQUIDITY SHORTAGE. AC WAS UNABLE TO PAY NOVEMBER SALARIES. IN EARLY DECEMBER GOP REPLACED ADMINISTRATION, ORDERED DETAILED INVESTIGATION OF AC'S BOOKS, AND MINISTER OF LABOR PAID TWO WEEKS' WORTH OF WAGES. MINISTER ALSO ANNOUNCED THAT TORRALTA'S CONTRACTUAL OBLIGATIONS TO ITS LIMITED OFFICIAL USE

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ASSOCIATE WOULD BE ENFORCED.

6. RUMORS ABOUT TORRALTA'S ECONOMIC ILLNESS HAVE BEEN RAMPANT FOR SOME TIME. THE CAUSE OF ITS FINANCIAL DIFFICULTIES IS COMPLEX AND NOT FULLY KNOWN AT THIS TIME. IT IS SURELY A COMBINATION OF FACTORS INCLUDING A DOWNTURN IN TOURISM, THE LIQUIDITY SQUEEZE, AND PROBABLY MISMANAGEMENT OR WORSE.

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7. WHILE THERE ARE NO EXACT STATISTICS ON TOURISM, IT IS CLEAR THAT IT IS SIGNIFICANTLY DOWN. ACCORDING TO MOST RECENT GOP DATA HOTEL GUESTS IN PORTUGAL WERE DOWN 12 PERCENT FOR THE FIRST SEVEN MONTHS. OTHER GOP OFFICIALS HAVE ESTIMATED THE REDUCTION IN TOURIST RECEIPTS AT 17 PERCENT THROUGH OCTOBER. TORRALTA ITSELF REPORTS ITS MONTHLY OCCUPATION RATES IN THE ALGARVE FOR 1974 HAVE DROPPED (BETWEEN 2 AND 19 PERCENT) FOR EVERY MONTH EXCEPT FEBRUARY (UP 2 PERCENT). ITS TOTAL 1973 OCCUPATION RATE WAS 41 PERCENT COMPARED TO 48 PERCENT IN 1972 AND 45 PERCENT THE YEAR BEFORE.

8. MUCH OF TORRALTA'S GROWTH WAS THE RESULT OF A QUICK TURN-OVER OF FUNDS. ANY NEW CAPITAL (WHICH WAS RAISED AT A HIGH PREMIUM) AS WELL AS ITS REGULAR INCOME WAS IMMEDIATELY REINVESTED IN NEW ACQUISITIONS. ITS POLICY WAS LARGELY DEPENDENT UPON A CONTINUED TOURISM BOOM AND THE CONTINUED INVESTMENT IN HOLIDAY VOUCHERS. (NOTE: METHOD OF OPERATION, A VIRTUAL "HOUSE OF CARDS" BASED ON SUPPOSITION OF CONTINUED GROWTH, APPEARS VERY SIMILAR TO THAT WHICH LED JORGE DE BRITO'S BANCO INTERCONTINENTAL PORTUGUES (BIP) INTO DIFFICULTY (REF B).) ITS CASH RESERVES WERE NEVER LARGE. WHEN TOURISM WENT DOWN, AND INVESTOR CONFIDENCE SOURED, DUE TO PERSISTENT RUMORS OF FINANCIAL PROBLEMS

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AND DOMESTIC POLITICAL INSTABILITY, THE CHAIN WAS BROKEN AND PARTS OF THE GROUP FOUND THEMSELVES SHORT OF CASH TO PAY

THEIR CURRENT OBLIGATIONS. TRADE SOURCES REPORT THAT NO ONE HAS BEEN BUYING HOLIDAY VOUCHERS IN RECENT MONTHS AND MANY PREVIOUS PURCHASERS ARE REQUESTING REDEMPTION FOR CASH.

9. A GREAT DEAL OF CONTROVERSY CENTERS ON THE "INVESTMENTS IN PROCESS" LINE ON THE ASSET SIDE OF TORRALTA'S BALANCE SHEET. AT END OF 1973 THIS FIGURE -- \$56 MILLION -- CONSTITUTED ABOUT ONE-THIRD OF TOTAL ASSETS. SOME QUESTION HOW THE BUILDINGS IN PROCESS ARE VALUED, WHETHER AT ACTUAL CONSTRUCTION COST OR AT A PROJECTED MARKET VALUE OF THE PROJECT WHEN FINISHED. SOME SPECULATE THAT TORRALTA ACCOUNTANTS ARE ATTEMPTING TO CAPITALIZE PRE-PAID INTEREST BY INCLUDING IT IN THIS FIGURE, THUS INFLATING ITS ASSETS. THE RESPECTED WEEKLY PAPER EXPRESSO POINTED OUT THAT THESE INVESTMENTS IN PROCESS TOTAL OVER 50 PERCENT OF FIXED ASSETS WHICH IT CHARACTERIZES AS AN "EXCEPTIONALLY HIGH PERCENTAGE". IT ATTRIBUTES THE "INFLATED" FIGURE TO INCLUSION OF IRREGULAR FOREIGN EXCHANGE DEALINGS BUT DOES NOT ELABORATE ON THE ACCOUNTING METHODS. THESE FOREIGN EXCHANGE DEALINGS ARE REPORTEDLY THE BASIS FOR CHARGE (D). TORRALTA REPORTEDLY USED EXCHANGE HOUSES (CAMBIOS), RATHER THAN BANKS, TO RECEIVE AND REMIT HOLIDAY VOUCHER-RELATED PAYMENTS ABROAD. THE EXCHANGE HOUSES ARE NOT REQUIRED TO GET BANK OF PORTUGAL AUTHORIZATION TO MOVE SMALL AMOUNTS OF FUNDS FOR TOURISM PURPOSES IN AND OUT OF THE COUNTRY BUT AUTHORIZATION IS PROBABLY REQUIRED FOR THE VOUCHER TRANSACTIONS. OTHER SPECULATION CENTERS ON THE RUMORED POCKETING OF MILLIONS OF DOLLARS OF COMMISSIONS FROM SALES OF SHARES AND PROPERTIES AND ON INTRA-CONGLOMERATE SALES OF REAL ESTATE. WHILE NOTHING HAS YET BEEN PROVED, THE GENERAL CONSENSUS OF BUSINESSMEN SEEMS TO BE THAT TORRALTA ADMINISTRATORS ARE GUILTY FOF BREAKING THE LAW.

10. COMMENT: IT IS IMPOSSIBLE TO GAUGE THE EFFECT OF TORRALTA'S FINANCIAL PROBLEMS ON PORTUGAL. THE GOP HAS INTERVENED AND IS PUBLICLY COMMITTED TO SAVING THE FUNDS OF THE SMALL INVESTORS. REPORTED LARGE SALES OF VACATION VOUCHERS TO PORTUGUESE WORKERS IN NORTHERN EUROPE AND TO NORTHERN EUROPEANS ASSURES THAT THE REPERCUSSIONS WILL BE DIRECTLY FELT OUTSIDE OF PORTUGAL. (THERE IS LITTLE KNOWN TORRALTA ACTIVITY IN THE U.S.). THE TOURISM SECTOR IS ONE OF MOST IMPORTANT TO ECONOMY. IT IS THE SECOND LARGEST LIMITED OFFICIAL USE

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EARNER OF FOREIGN EXCHANGE--ALMOST \$300 MILLION IN 1973--AND TORRALTA IS ITS MOST IMPORTANT FIRM. IT OWNS OR CONTROLS 3 PERCENT OF ALL HOTEL BEDS, HAD ALMOST 4 PERCENT OF ALL HOTEL GUESTS IN 1973 AND EMPLOYS ABOUT 8 PERCENT OF ALL WORKERS IN TOURISM SECTOR. GOP INTERVENTION AND ITS ULTIMATE DISPOSITION OR MANAGEMENT OF FIRM IS BEING WATCHED CLOSELY BY PORTUGUESE BUSINESSMEN. THE HANDLING OF THE CRIMINAL CASES IS A CONCERN TO SOME WHO MAY HAVE BEEN TECHNICALLY OUTSIDE THE LAW WHILE ENGAGING IN WHAT WAS CONSIDERED "NORMAL PRACTICE". MANY

PRACTICES WHICH WERE ALLOWED UNDER THE PREVIOUS REGIME MAY  
BE CONSIDERED ILLEGAL NOW. FINALLY, THE CASE WILL BE FOLLOWED  
IN WESTERN EUROPE AND FOREIGN INVESTMENT/DECISIONS MAY DEPEND  
UPON DEVELOPMENTS WITH TORRALTA.  
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## Message Attributes

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**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** NATIONALIZATION, CENTRAL GOVERNMENT, BANKS  
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**Draft Date:** 21 DEC 1974  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
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**Disposition Approved on Date:**  
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**Enclosure:** n/a  
**Executive Order:** N/A  
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**Previous Channel Indicators:**  
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**Reference:** 74 LISBON 5538, 74 LISBON 4604, 74 WTDR DATED NOV 12  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** ElyME  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 29 MAY 2002  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <29 MAY 2002 by rowelle0>; APPROVED <31 MAR 2003 by ElyME>  
**Review Markings:**

Declassified/Released  
US Department of State  
EO Systematic Review  
30 JUN 2005

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** BACKGROUND ON TORRALTA GROUP PROBLEMS  
**TAGS:** BBSR, EIND, PO  
**To:** STATE  
**Type:** TE  
**Markings:** Declassified/Released US Department of State EO Systematic Review 30 JUN 2005